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**Financial reports and audited financial statements, and reports of the Board of Auditors**

# Financial reports and audited financial statements and reports of the Board of Auditors for the biennium ended 31 December 2005

## Report of the Advisory Committee on Administrative and Budgetary Questions

### Addendum

1. The Advisory Committee on Administrative and Budgetary Questions considered the report of the Board of Auditors on the financial statements of the United Nations Office for Project Services (UNOPS) for the biennium ended 31 December 2005 (A/61/5/Add.10). The Committee also had before it an advance unedited copy of the report of the Secretary-General on the implementation of the recommendations of the Board of Auditors on the financial statements of UNOPS for the biennium ended 31 December 2005 (A/61/214/Add.2), which contains the responses of UNOPS to the Board's recommendations. During its consideration of the reports, the Advisory Committee met with members of the Audit Operations Committee, as well as with the Executive Director and other representatives of UNOPS, who provided additional information and clarification.

2. The background concerning the late submission of the Board's report on UNOPS is outlined in paragraphs 12 to 17 of that report (A/61/5/Add.10; chap. II). In brief, the Board suspended the audit of UNOPS in May 2006 because certified financial statements for the biennium 2004-2005 were not provided to the Board in accordance with the Financial Regulations and Rules (see General Assembly resolution 61/233A, para. 8). Furthermore, the Board's review of the draft financial statements provided indicators of significant misstatements and errors (see A/61/182, para. 12). Accordingly, in June 2006, the Executive Board of UNOPS requested UNOPS to ensure the availability of certified financial statements by 30 November 2006, and the audit was postponed. Certified financial statements were submitted to the Board on 21 November 2006 and, on the basis of audit observations, were revised and resubmitted to the Board on 25 January 2007.

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3. As noted in paragraph 16 of the report of the Board of Auditors (A/61/5/Add.10, chap. II) and paragraphs 6 to 17 of the report of the Secretary-General (A/61/214/Add.2), UNOPS undertook a comprehensive financial clean-up exercise during the period from July to December 2006, which resulted in the identification and correction of extensive errors committed in the period 1999-2005. A consulting firm was hired to assist with the reconciliations of accounts, including the inter-fund account with the United Nations Development Programme (UNDP) (see also paras. 5 and 6 below). As indicated in paragraph 10 of the report of the Secretary-General, the overall cost of the financial clean-up effort amounted to approximately $2 million.

4. Other major initiatives have included the establishment of a new senior management team and organizational restructuring, investment in a professional-level finance team, decentralization of functional accounting activity and the relocation of the UNOPS headquarters office from New York (Chrysler Building) to Copenhagen. In addition, in 2007 UNOPS formed an internal audit function, led by the Head of Audit and supported by a team of internal auditors. The function had previously been entrusted to a team of dedicated auditors at UNDP. Furthermore, as noted in paragraph 15 of the report of the Secretary-General, UNOPS is in the process of recruiting members for a soon-to-be-formed audit and advisory committee. The committee, whose membership is to be external to UNOPS, will meet at least quarterly to provide guidance and oversight of the UNOPS audit function and ensure that the organization employs sound risk-management practices. Upon enquiry, the Advisory Committee was informed that the membership of the audit and advisory committee was nearly complete and that all of the members integrated thus far had agreed to provide their services to the committee pro bono, with the organization paying only travel and subsistence costs. **The Advisory Committee welcomes these developments.**

5. The Board has issued a qualified opinion on the financial statements of UNOPS for the period ended 31 December 2005. The qualification relates to an unreconciled balance of $9.9 million in the UNOPS/UNDP inter-fund account. According to the Board, the two entities have not been properly reconciling the amount due/payable to each other. As at 31 December 2005, an amount of $9.9 reflected as a receivable from UNDP could not be confirmed with UNDP. UNOPS raised a provision of $5 million against this receivable in its 2004-2005 financial statements.

6. The Board has recommended that UNOPS: (a) reassess the recoverability of the UNDP debt of $9.9 million; (b) assess the adequacy of the $5 million provision raised for write-off; and (c) ensure that all inter-fund reconciliations are performed regularly. For its part, the Administration of UNOPS explained that the large volume and age of the transactions comprising the unreconciled balance of $9.9 million would complicate a review (see A/61/5/Add.1, chap. II, paras. 95-96). Further, in the report of the Secretary-General on implementation of the recommendations of the Board, the Administration of UNOPS stated its belief that further investment in reconciliation would not be likely to produce additional positive results; it therefore intended to work with UNDP to settle the $9.9 million before the close of 2007. The Administration of UNOPS also expressed the view that the $5 million provision reflects a reasonable pro rata share of the portion of the $9.9 million balance (see A/62/214/Add.2, paras. 24-25). Upon a request for further clarification, members of the Audit Operations Committee expressed the opinion that the amount of $5 million

appeared arbitrary and that criteria should be developed and agreed with UNDP concerning the types of items that should be written off. **The Advisory Committee expects a prompt settlement of these pending issues (see also para. 12 below).**

7. The Board has also emphasized a number of matters of concern, including:

(a) The low level of operational reserves ($4.36 million as at 31 December 2005);

(b) The fact that, although in the preparation of financial statements for the current biennium UNOPS has addressed concerns of the Board relating to imprest accounts, the UNDP/United Nations Population Fund inter-fund account, non-expendable equipment and staff separation costs, no adjustment has been made in the comparative information disclosed in the financial statements for 2004-2005;

(c) Costs and delays arising from weaknesses in the accounting and internal control system;

(d) The provision by UNOPS for losses of $2.76 million relating to project costs incurred without authorized budgets and declared write-offs of $1.38 million relating to project costs that could not be recovered, leading to concerns about the effectiveness of the cost control of projects and the potential for further losses or under-recoveries;

(e) Activities affecting the control environment and project deliverables, including lack of donor authorization to incur expenditure, inadequate accounting controls over expenditure and non-expendable property, lack of transparency and consistency in the funding and fee-setting process for projects and instances of lack of control over the management of procurement;

(f) The continued use of an incorrect balance of $10 million for non-expendable equipment for the biennium 2002-2003 for the purpose of comparison in the financial statements for the biennium 2004-2005;

(g) Lack of regular reconciliation of bank and imprest accounts and closure of imprest accounts before year's end, resulting in some transactions not being recorded.

8. The Board made a number of other observations as part of its review of the financial statements. In the Board's view, those observations, some of which are being addressed by UNOPS as part of its financial clean-up, raise concerns about the history of financial management, control environment and risk management and its ongoing negative impact on the financial health of UNOPS (see A/61/5/Add.10, chap. II, para. 30). The related observations made by the Board included the following:

(a) Regular cash-flow forecasts were not performed throughout the biennium;

(b) Advance payment by clients for certain projects were sometimes used to pay creditors or to make disbursements for other projects in advance of the receipt of funds;

(c) Delays were noted in the processing of imprest and payroll transactions to the general ledger;

(d) The dependency on UNDP for approximately 45 per cent of its revenue poses a risk to UNOPS;

(e) UNOPS project budgets and forecasts were not prepared for the full project life cycle, but covered only periods of one or two years;

(f) As at August 2006, many projects still needed to be operationally and/or financially closed;

(g) Some senior posts remained vacant or were filled only temporarily during certain periods in the biennium;

(h) Project income is not matched with project expenditure over the lifetime of a project;

(i) There is a declining trend in the percentage fee earned by UNOPS on its project portfolio.

9. In paragraphs 26 to 41 of its report, the Board highlights the financial and operational risks that UNOPS faces and addresses the issue of its sustainability as a going concern. As noted in paragraph 38 of the report, one factor contributing to the risk of UNOPS being unable to continue as a going concern was the level of its operational reserve. UNOPS recorded a net shortfall of $18.8 million for the biennium 2004-2005, resulting in a decrease in the operational reserve from $23.1 million in the biennium 2002-2003 to $4.4 million in 2004-2005. The level of the reserve is adjusted annually to represent 4 per cent of the average total expenditure over the previous three years. On the basis of this requirement, the 2004-2005 operational reserve balance should have been approximately $27.4 million. As indicated in paragraph 24 of the Board's report, during the audit the management provided the internal management accounts for the year ended 31 December 2006, which reflected a surplus and an improvement in reserves. In this connection, it is stated in paragraph 21 of the report of the Secretary-General (A/61/214/Add.2) that UNOPS produced a contribution of $8.9 million to the existing reserve, bringing it to $13.2 million at the close of 2006. The Board did not audit the results provided for 2006. It notes, however, that on the basis of projections, the operational reserve for 2006-2007 should be $32.6 million, whereas it was projected to be only $18.9 million (see A/62/5/Add.10, chap. II, para 38).

10. The seriousness of the situation is further reflected in two letters sent by the Controller, on 14 June 2006 and 20 July 2007, to all heads of departments and offices involved with UNOPS-implemented projects. In the first letter, the Controller, in view of the unclear financial situation of UNOPS, stressed the need for caution to be exercised in undertaking new or extended projects with UNOPS and stated that the provision of financial advances for projects to be undertaken with UNOPS should be made quarterly as opposed to annually. In the second letter, the Controller, consequent to the Board's report for the year ended 31 December 2005, requested the Office of Internal Oversight Services to review the internal controls and financial management practice in UNOPS relating to projects funded by United Nations sources in order to assess the Organization's exposure to any financial and/or operational risk. Pending completion of the review, the durations of service agreements with UNOPS were increased: for activities financed through peacekeeping budgets the duration is to be 1 July to 31 December 2007, and for those financed through voluntary contributions, any new agreement is to have a duration ending before 31 December 2007.

11. At its second regular session of 2007, held from 10 to 14 September, the Executive Board of UNDP/UNFPA adopted two decisions of relevance to the Advisory Committee's discussions on UNOPS. In its decision 2007/37, the Executive Board, inter alia, took note with concern of the report of the Board of Auditors, noted the progress made by the new UNOPS management to address financial and other related issues and requested UNOPS to report to it at its second regular session of 2008 on the status of implementation of the recommendations of the Board of Auditors. The Executive Board also considered a proposal for the partial merger of certain functions of the UNDP Inter-Agency Procurement Services Office with UNOPS. By its decision 2007/38, the Executive Board, inter alia, welcomed the transfer of the direct procurement functions carried out by the Inter-Agency Procurement Services Office with respect to common user items and the associated strengthening of UNOPS as a central procurement resource to the United Nations and requested the Executive Director to include, in his annual report to the Executive Board, an overview of UNOPS clients and services and information on the implementation of the partial merger, including the provision of services to non-governmental organizations. The texts of those decisions are annexed to the present report.

## Conclusion

12. **The Advisory Committee concurs with the recommendations of the Board on the financial statements of UNOPS for the biennium 2004-2005. The Committee is deeply concerned at the gravity of the financial problems indicated by the findings of the Board and notes that the report is unprecedented in the scope of issues of qualification. While the Committee welcomes recent measures taken by UNOPS to address these problems, it shares the Board's concerns regarding the sustainability of the organization as a going concern.**

13. In the Advisory Committee's discussions with members of the Audit Operations Committee, a number of additional risk factors were noted. For example, with the financial problems it is facing, UNOPS may find itself in a position where it must take on larger, riskier projects with lower profit margins. Were only one such project to go badly, the $4.4 million reserve could be eliminated or drastically reduced. Furthermore, the addition of senior staff as part of the restructuring of UNOPS and its management and finance teams will entail additional costs. Moreover, managerial changes of the magnitude described in the response by UNOPS do not come without risks; completely new senior management and finance teams, while they may yield a needed change in vision, may also mean that the organization loses experienced senior staff. In addition, the Committee was informed that the merger of the Inter-Agency Procurement Services Office and UNOPS would entail the creation of 32 positions in UNOPS (10 Professional and 22 General Service). The cost of those posts, which is estimated at approximately $4.5 million annually, will be incorporated in the 2008-2009 budget submission. The intention is that the additional budget would be fully covered by the expected income from services. The Committee also notes that, while it is asserted in paragraph 9 of the report of the Secretary-General on the implementation of the Board's recommendations (see A/61/214/Add.2) that the relocation of the

headquarters office will lead to lower overall operating costs, it is not clear what the cost reduction will be.

14. **Despite the situation outlined above, the Advisory Committee believes it is appropriate to allow UNOPS reasonable time to implement fully the recommendations of the Board, as well as its own reforms. In the meantime, the Committee intends to remain seized of this matter and will discuss it in detail with representatives of UNOPS and UNDP in the context of its consideration of their budgets, which are to be presented to the Committee in the coming months. The Committee also looks forward to discussing with the management of UNOPS the findings of the Office of Internal Oversight Services review (see para. 10 above), which it understands will be completed by the end of October 2007.**

# Annex

## Decisions of the United Nations Development Programme/ United Nations Population Fund Executive Board at its second regular session of 2007 on the United Nations Office for Project Services

**2007/37**
**Implementation of the recommendations of the Board of Auditors, 2004-2005**

*The Executive Board*

1. *Takes note of, with concern*, the report of the Board of Auditors on the UNOPS financial statements for the biennium ended 31 December 2005 (Ad/61/5/Add.10);

2. *Notes* the progress made to date by the new UNOPS management to address financial and other related issues that had accumulated over a number of years;

3. *Takes note* of the report from UNOPS on the recommendations of the Board of Auditors for the biennium 2004-2005 (DP/2007/48), and *requests* UNOPS to report on the status of this implementation to the Board at its second regular session 2008.

**2007/38**
**Proposed partial merger of certain functions of IAPSO with UNOPS**

*The Executive Board*

1. *Welcomes* the transfer of the direct procurement functions carried out by UNDP/Inter-Agency Procurement Services Office (IAPSO) with respect to common user items and the associated strengthening of UNOPS as a central procurement resource to the United Nations system;

2. *Decides* that UNOPS is mandated to provide services to international non-governmental organizations (NGOs), where such provision furthers United Nations programmes and priorities of governments and is consistent with existing service provided by UNOPS, subsidiary to its core task of servicing the United Nations system;

3. *Decides* that, as of 2008, UNOPS will assume the responsibility given to UNDP/IAPSO pursuant to decisions 96/2 and 96/35 of compiling and submitting to the Executive Board, at its second regular session, the annual statistical report on the procurement activities of United Nations system organizations;

4. *Requests* the Executive Director to include, in his annual report to the Executive Board, an overview of UNOPS clients and services and information on the implementation of the partial merger, including provision of services to NGOs.

*14 September 2007*